IN THE MATTER OF THE APPLICATION REGARDING CONVERSION OF PREMERA BLUE CROSS AND ITS AFFILIATES

Washington State Insurance Commissioner's Docket # G02-45

PRE-FILED DIRECT TESTIMONY OF:

John M. Steel

March 31, 2004

CONFIDENTIAL and PROPRIETARY
NOT FOR PUBLIC DISCLOSURE

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Introduction

Q. Please state your name.

A. My name is John M. Steel.

Q. State your position and business address.

A. I am a partner in the law firm of Gray Cary Ware & Freidenrich LLP, 701 Fifth Avenue, Suite 7000, Seattle, Washington.

Q. What is the purpose of your testimony?

A. I have been engaged by PREMERA, a Washington miscellaneous not-for-profit corporation ("PREMERA"), Premera Blue Cross, a Washington not-for-profit corporation ("Premera BC" and, together with PREMERA, "Premera"), and various of their affiliates to provide an independent expert opinion on issues of Washington law and practice in connection with Premera's application for conversion from not-for-profit to for-profit status (the "Proposed Conversion"). The Proposed Conversion is described in the Form A Statement filed by New PREMERA Corp. ("New PREMERA") with the Office of the Insurance Commissioner ("OIC") on September 17, 2002, as amended by the Amended Form A Statement filed by New PREMERA with the OIC on February 5, 2004 (as amended, the "Form A Filing").

Q. Have you submitted expert reports for this proceeding?

A. Yes. I filed a Report in this proceeding dated November 10, 2003, as well as a Supplemental Report dated March 5, 2004. Complete and accurate copies of my Report and Supplemental Report will be marked as Premera Hearing Exhibits. I incorporate both my Report and my Supplemental Report into my pre-filed direct testimony by reference.

Q. Describe your qualifications and experience with Washington corporate law.

A. I have been an attorney in the full-time private practice of law in Seattle, Washington, since 1970. For over 31 years, my practice has focused almost exclusively on corporate and securities law matters. I have negotiated and managed over 200 merger/acquisition transactions (including several sales or acquisitions of regulated insurers or healthcare service contractors), and have been primarily responsible for almost 30 initial public offerings (representing both issuers and underwriters, including two IPOs in connection with conversions of mutual banks to for-profit status). In the past three annual rankings of Washington lawyers, based on a peer survey conducted by Washington Law & Politics, I have been the highest-ranked corporate lawyer in Washington State. I am a long-time member of the Washington State Bar Association's Corporate Act Revision Committee, of which I was the Co-Chair for over ten years. I am also a former Chair of the Washington State Bar Association's Securities Law Committee.

My familiarity with Washington corporate law extends to nearly all of the statutes under which corporate entities may be organized in this state. I have authored and testified in favor of the legislative adoption of five separate amendments to the Washington Business Corporations Act (RCW Title 23B, applicable to for-profit corporations). I have also authored and supported the legislative process as to two amendments to the not-for-profit statute under which PREMERA is organized (RCW Ch. 24.06), including a 2001 updating of that statute's provisions relating to directors' duties. In addition to the representation of numerous for-profit Washington corporations, I have represented numerous not-for-profit Washington corporations organized under RCW Ch.

24.03 and RCW Ch. 24.06 (including other healthcare service contractors), and have advised them as to governance, financing and transactional matters. I am frequently asked to speak at bar association, continuing education and industry group symposiums on matters of Washington corporate law, corporate governance and securities law.

A true and correct copy of my current resume is attached as **Exhibit A** and incorporated herein by reference; it will be marked as a Premera Hearing Exhibit.

Q. Please summarize your testimony.

A. The Form A Filing and the corporate decision-making processes underlying the Form A Filing comply with Washington law. Based upon my review of the background materials and information available to me, I conclude:

1. Premera's status as a not-for-profit corporation does not automatically render it a charitable corporation or cause its assets to be impressed with a charitable trust under Washington law. Premera is essentially a commercial enterprise and not a public benefit corporation. None of Premera's assets appear to be impressed with a charitable trust. Even if some portion of Premera's assets were considered subject to charitable limitations, the structure of the Proposed Conversion satisfies the transfer requirements of RCW 24.03.225(3). The Proposed Conversion makes far more assets available to Washington and Alaska for charitable purposes than are available now.
2. In reaching its decision to pursue the Proposed Conversion, the Board of Directors of PREMERA (the "PREMERA Board") and the Board of Directors of Premera BC (the "Premera BC Board" and, together with the PREMERA Board, the "Premera Board") fulfilled their respective fiduciary duties under

Washington law in investigating and assessing alternatives for capital formation via possible merger or combination with other healthcare insurers. The Premera Board's deliberative process met the requisite standard of care, and its decision to pursue the Proposed Conversion rather than other business combination alternatives should be entitled to the protection of the business judgment rule.

3. The overall structure of the arrangements between New PREMERA and the Washington Foundation Shareholder (the "Washington Foundation") and the Alaska Health Foundation (collectively, the "Foundations")—including that reflected in the Registration Rights Agreement, the Voting Trust and Divestiture Agreements, and the Transfer, Grant and Loan Agreement—is reasonable and customary, including those aspects of structure that also serve to comply with the Blue Cross Blue Shield Association ("BCBS") license.

Premera's assets are not subject to a charitable trust.

Q. Premera currently is organized as a non-profit corporation. Does that mean that it is a charitable corporation?

A. No. Washington not-for-profit corporations are not automatically deemed to be charitable. The court in Adult Student Housing v. Dep't of Revenue, 41 Wn. App. 583, 593, 705 P.2d 793, 798 (1985), for example, held that being a not-for-profit corporation "does not alone make a corporation benevolent or charitable." Similarly, in Adolescent Treatment Servs. v. Ahvakana ("Adolescent Treatment"), 97 Wn. App. 1087 (1999) (unpublished table decision, text available at 1999 WL 1034515 *3), review denied, 141 Wn.2d 1004 (2000), the court held that a not-for-profit corporation "is not a charitable trust. As a corporation, its powers are defined by RCW 24.03."

In 1969, the Washington Legislature adopted a new not-for-profit corporation act (RCW Ch. 24.03) based upon the Model Non-Profit Corporation Act of 1964 (the "1964 Model Act"). The new Washington statute did not recognize the concept of a charitable corporation.

Almost 20 years after Washington enacted the 1964 Model Act, the drafters of the Model Non-Profit Corporation Act of 1987 (the "1987 Model Act") recognized that certain "public benefit corporations" may be charitable in nature. The 1987 Model Act classifies not-for-profit organizations into three major categories: "public benefit," religious and "mutual benefit" corporations. A "public benefit corporation" under the 1987 Model Act is one that is organized for a public or charitable purpose and that, upon dissolution, must distribute its assets to the U.S., a state, or an entity or person that is exempt from federal taxation under 26 U.S.C. 501(c)(3). The Washington Legislature, however, has never adopted this concept. Instead, it adopted its own very narrow definition of a "public benefit nonprofit corporation."

Under the Washington Legislature's definition, only not-for-profit corporations that are tax exempt under 26 U.S.C. 501(c)(3) may hold themselves out "as operating to benefit the public." Ch. 291, § 1, Laws of Washington 1989 (legislative finding). This very narrow definition evidences the Legislature's view that not all not-for-profit corporations, but rather only tax-exempt 501(c)(3) corporations, should be considered charitable or public benefit organizations under Washington law. This limitation is logical because the eligibility criteria under 501(c)(3) are basically the same as those comprising the common law definition of a charity. Neither PREMERA nor Premera BC

is now or has ever been eligible for tax exempt status under section 501(c)(3). Hence, they are not and cannot be "public benefit nonprofit corporations" under Washington law.

Q. Do you believe that the assets of current Premera—that is, not-for-profit Premera—are impressed with a charitable trust?

A. No, I have no basis to believe that Premera's assets are impressed with a charitable trust.

Q. Please explain.

A. The Washington Legislature's narrow view as to which not-for-profit corporations should be deemed to be operating for the public benefit is consistent with Washington law relating to the imposition of charitable trust restrictions. I am not aware of any reported case in Washington that has imposed a charitable trust on the assets of a not-for-profit corporation, and what little case law exists in Washington as to "charitable" status arises in very different contexts. In addition, it is questionable whether the charitable trust concept, as applied to not-for-profit corporations, even exists in this state. Adolescent Treatment held that a not-for-profit corporation "is not a charitable trust. As a corporation, its powers are defined by RCW 24.03." In Lundberg v. Coleman ("Lundberg"), 115 Wn. App. 172, 60 P.3d 595 (2002), review denied, 150 Wn.2d 1010 (2003), the court questioned whether a section 501(c)(3) nonprofit corporation qualified for, or was, a charitable trust.

Courts in other states have generally ruled, following the adoption of not-for-profit corporation statutes, that such corporations are governed by corporate, not trust, standards. For example, the Kansas Supreme Court held in United Methodist Church v. Bethany Med. Ctr., 266 Kan. 366, 969 P.2d 859 (1998), that a not-for-profit charitable corporation running a hospital was governed by Kansas' not-for-profit corporation law

rather than trust law. According to one commentator, the drafters of the 1987 Model Act expressly intended to eliminate the application of the charitable trust doctrine to not-for-profit corporations even if they were formed for charitable purposes. Lizabeth A. Moody, "The Who, What, and How of the Revised Model Nonprofit Corporation Act," 16 N. Ky. L. Rev. 251, 263-64 (1989).

Leaving aside the debate as to whether charitable trust concepts even can be applied to a modern not-for-profit corporation, I believe that before a Washington court would consider doing so, it would require a clear showing of not only the "charitable" nature of the corporation's activities, but also an intent by the donor of the corporation's assets that they be utilized solely for charitable purposes. The court held in Baarslag v. Hawkins, 12 Wn. App. 756, 763-64, 531 P.2d 1283 (1975), review denied, 86 Wn.2d 1008 (1976), that a charitable trust is created only if the donor limits the use of funds to charitable purposes or, conversely, prohibits their use for non-charitable purposes.

The predominant importance of the donor's intent under Washington law is reinforced by the specific language of RCW 24.03.225(3), which provides that, upon dissolution of a not-for-profit corporation, any assets that were "received and held by the corporation subject to limitations permitting their use only for charitable, religious, … benevolent, … or similar purposes … shall be transferred or conveyed to one or more domestic or foreign corporations, societies or organizations engaged in activities substantially similar to those of the dissolving corporation…." The statute's careful restriction of "charitable trust"-like transfer limitations to those assets that were "received" by the not-for-profit corporation subject to explicit charitable use limitations and are still held for such uses is consistent with and supportive of my view expressed

above that Washington courts would, in any event, require a clear showing of the donor's intent to impose charitable use restrictions on corporate assets.

Although Washington courts have not ruled on the application of this dissolution provision, most cases from other jurisdictions with the same or similar provisions have interpreted this language to require a showing of the donor's restrictive intent before "charitable trust"-like transfer restrictions will be imposed. For example, New York's highest court stated: "Assets legally required to be used for a particular purpose are those received pursuant to a will or other instrument limiting the purpose for which the assets may be used." In re Multiple Sclerosis Serv. Org. of New York, Inc., 68 N.Y.2d 32, 39 n.5, 496 N.E.2d 861, 864 n.5, 505 N.Y.S.2d 841, 844 n.5 (1986). The Alabama Supreme Court ruled that the Alabama dissolution statute, which is identical to RCW 24.03.225(3), did not apply to a transfer of real estate "because the deed conveying the property to [the not-for-profit corporation] did not contain conditions or limitations on the property's use." City of Fort Payne v. Fort Payne Athletic Ass'n, Inc., 567 So.2d 1260, 1264 (Ala. 1990). Even in Texas, which has interpreted this language more broadly, it still must be shown that the assets were "received" by a charitable corporation with an intent, either express or implied, that the assets be used only for charitable purposes. Blocker v. State, 718 S.W.2d 409, 415 (Tex. Ct. App. 1986).

RCW 24.03.225(3) applies to transfers of assets in a plan of dissolution by a not-for-profit corporation only to the extent that those assets were "received and [are] held" for charitable purposes. This requires a showing of (i) a donor's intent that the assets given to the corporation be used for express charitable purposes (or that they not be used for non-charitable purposes), and (ii) that the not-for-profit corporation holds these

donated assets for charitable purposes. In other jurisdictions that have analyzed the "charitable" status of a BCBS licensee, the courts have focused on the factual record to determine whether such corporations were charitable or whether their assets should be impressed with a charitable trust. In such cases, the courts in both Wisconsin (ABC for Health, Inc., v. Comm'r of Ins., 250 Wis.2d 56, 70-71, 640 N.W.2d 510, 515-16 (2001), review denied, 252 Wis.2d 149, 644 N.W.2d 686 (2002)) and Texas (Abbott v. Blue Cross and Blue Shield of Tex., Inc., 113 S.W.3d 753, 766 (Tex. Ct. App. 2003)) examined the factual evidence and concluded that no charitable trust restrictions applied. Some other courts (see, e.g., Hawes v. Colo. Div. of Ins., 32 P.3d 571 (Colo. Ct. App. 2001), Blue Cross and Blue Shield of Kan., Inc. v. Stovall, 2000 WL 34001584 (Kan. Dist. Ct. 2000), and other cases cited in my Supplemental Report) have looked at BCBS conversions and have based their rulings, not on an analysis of charitable purpose or charitable trust, but instead on the provisions of not-for-profit conversion statutes or unique provisions in the not-for-profit corporation statutes of those states.

In his December 2003 deposition (transcript pp. 75-77, 88-92), Mr. Cantilo argued that the numerous cases that have been cited are very fact-specific and therefore distinguishable from the Premera case. He is correct that they are fact-specific, but he is wrong in his conclusions. The import of the cases is that any determination regarding the existence or non-existence of a charitable trust as to a BCBS licensee must necessarily be based upon an analysis of the facts. Yet, when it comes to analyzing the Proposed Conversion, Cantilo & Bennett ("C&B"), an OIC consultant, insists on "assuming" that a charitable trust exists and avoiding the factual analysis necessary to support such a conclusion. This approach is not permissible under Washington law or any of the other

case law set out above—one cannot simply assume or presume a charitable purpose or the existence of a charitable trust based on nothing more than general rhetoric about the history of other organizations in other jurisdictions with different statutory provisions. No *facts* have been cited to show that Premera is a charitable trust.

Q. Do you believe the Washington Legislature has ever intended or believed that assets of a not-for-profit healthcare insurer should be subjected to a "charitable trust"-like protective process?

A. No, and the statutory history supports my conclusion. In 1996 and 1997, the attorneys general of several states became increasingly concerned about the conversion of not-for-profit healthcare corporations across the United States. Prior to that time, common law and not-for-profit corporation statutes provided state attorneys general limited authority to review conversion activities of these corporations. Through their national organization, the National Association of Attorneys General ("NAAG"), the participating attorneys general (which included the Washington Attorney General) developed a model conversion statute that was intended to clarify the role of attorneys general in protecting the assets of charitable not-for-profit corporations and to standardize the application of charitable trust provisions to healthcare nonprofits.

In 1997, the Washington Legislature approved a not-for-profit conversion statute, currently set forth in RCW Ch. 70.45, based in large part on drafts of the NAAG Model Act. However, while the NAAG Model Act and several other jurisdictions' conversion statutes applied to both not-for-profit hospitals and healthcare insurers, the Washington Legislature expressly limited the applicability of Ch. 70.45 to not-for-profit hospitals only. Ch. 70.45, which is similar to the NAAG Model Act except for its inapplicability

to not-for-profit healthcare insurers, presumes that a not-for-profit hospital holds charitable assets and that those assets need to be protected by the attorney general.

By stopping short of including healthcare insurers in Ch. 70.45, Washington fell into line with the majority of states that adopted conversion statutes during the 1996-1997 period (P. Bisesi, "Conversion of Nonprofit Health Care Entities to For-Profit Status," 26 Cap. U. L. Rev. 805 at 836 (1997)). This decision by the Legislature not to include healthcare insurers in Washington's conversion statute seems to me quite logical, since hospital care has for many decades been considered inherently charitable under both common law and tax law. By contrast, serious doubts existed and still exist as to the charitable nature of essentially commercial health insurance operations. Under established principles of statutory construction, the Washington Legislature's decision to exclude not-for-profit healthcare insurers from Ch. 70.45, in marked contrast to the broader sweep of the NAAG Model Act, gives rise to a presumption that the Legislature intended to reject the application of charitable trust restrictions to not-for-profit healthcare insurers in Washington. See Lundberg, 115 Wn. App. at 177-78, 60 P.3d at 599.

In May 2001, the Washington Legislature had yet another opportunity to impose charitable limitations upon not-for-profit healthcare insurers when it adopted RCW Ch. 48.31C (the "Holding Company Act"), but again the Legislature declined to do so. Although somewhat similar to Ch. 70.45 in that the Holding Company Act provides the OIC an opportunity to approve conversion transactions, the standards of review, the OIC's authority, and the general approach of these two statutes are remarkably different. For example, one of the stated purposes of the Holding Company Act is to protect against

insolvencies of healthcare contractors and health maintenance organizations (see House B. Rep. SHB 1792, Test., 57th Leg., 2001 Reg. Sess. (Wash. 2001)); by contrast, the stated purpose of Ch. 70.45 is to provide the state with the authority to safeguard the charitable and public assets of not-for-profit hospitals (RCW Ch. 70.45 pmbl.).

The basic approaches of the two statutes are also fundamentally different: Ch. 70.45 requires that the hospital show that the conversion transaction satisfies certain required elements, including fair value, due diligence and compliance with fiduciary duties; by contrast, the Holding Company Act seems to presume that the transaction is legally proper and permissible unless the OIC satisfies the burden of showing that the transaction is not financially viable or that anti-trust issues exist. In adopting the Holding Company Act, the Legislature had a clear second opportunity to apply charitable trust principles to not-for-profit healthcare insurers, but appears to have rejected the notion once again. Because the Legislature used language in the Holding Company Act that was significantly different from the language of Ch. 70.45, a logical inference under established principles of statutory construction is that the Legislature intended this different treatment of not-for-profit healthcare insurers.

In the C&B Legal Opinions, C&B makes the argument that these differences between the Holding Company Act and Ch. 70.45 do not imply a different legislative intent. Citing the statutory construction principle of *in pari materia,* C&B argues that, under this principle, the different standards of review under Ch. 70.45, including its fair value, due diligence and fiduciary duty requirements, can actually be imported into conversion proceedings under the Holding Company Act. However, under Washington law, the doctrine of *in pari materia* cannot be used to bridge such a wide gulf between

two statutory regimes. See State v. Houck, 32 Wn.2d 681, 203 P.2d 693 (1949); Hallauer v. Spectrum Props., Inc., 143 Wn.2d 126, 18 P.3d 540 (2001). In my view, the purposes and approach of RCW Ch. 70.45 and the Holding Company Act are so widely divergent as to be irreconcilable, and C&B's reference to the fact that they both deal with healthcare entities is not a sufficient basis for applying Washington's *in pari materia* doctrine. Rather than construing the Holding Company Act to include proof requirements like those of Ch. 70.45, I conclude that the Washington Legislature must be presumed to have rejected the application of such requirements—and of charitable trust principles—in proceedings under the Holding Company Act, including the current proceeding relative to the Proposed Conversion.

Q. Do you believe that Premera is a charitable organization?

A. Everything that I have reviewed leads me to believe that Premera is essentially a commercial enterprise that would be difficult to classify as a charitable organization under the Washington legal principles described above.

Q. Please explain.

A. As I noted earlier, neither PREMERA nor Premera BC can be termed a "public benefit nonprofit corporation" under Washington law, because they are not now and never have been eligible for tax-exempt status under 26 U.S.C. 501(c)(3). Because they are not and cannot be "public benefit nonprofit corporations" under Washington law, they may not hold themselves out "as operating to benefit the public."

More importantly, Premera provides services only to those individuals with whom it has a contractual relationship, and virtually all assets received by Premera are cash payments for services rendered, which can hardly be said to have been given by

customers with any donative or restrictive intent. The source of Premera's revenues (and thus its accumulated assets) is identical to that of a for-profit healthcare insurer. In 1985, the U.S. Congress recognized that there was essentially no difference between not-for-profit and for-profit commercial corporations that provide healthcare insurance, characterizing the so-called social welfare organizations (such as BCBS licensees that provide healthcare insurance) as "so inherently commercial" that their tax-exempt status should be revoked. H.R. Rep. No. 426, 99th Cong., 1st Sess. at 664 (1985). Against this factual backdrop, it seems highly doubtful that Premera's assets are the subject of a charitable trust. Indeed, the only reported judicial decisions of which I am aware (the Wisconsin and Texas cases I cited earlier) in which courts in other states have conducted a factual inquiry into the "charitable" status of BCBS licensees have concluded that the BCBS affiliates were *not* charities and that their assets were *not* subject to charitable trust restrictions.

Q. Does the fact that Premera had a federal tax exemption until 1986 make it charitable?

A. No. The OIC's consultants have also argued that Premera is charitable by nature, or at least that its assets should be impressed with a charitable trust, because Premera BC operated prior to 1986 pursuant to a federal income tax exemption. However, this argument is faulty in that Premera BC's tax exemption was not pursuant to section 501(c)(3), the exemption available to not-for-profit entities that operate exclusively for religious, charitable, or scientific purposes (among others). Instead, Premera BC operated under section 501(c)(4), an exemption applicable to not-for-profit entities operating for the "promotion of social welfare" rather than for charitable purposes. (PREMERA, incorporated in 1994, has never been tax exempt.) Unlike charitable

organizations exempted under section 501(c)(3), section 501(c)(4) organizations are not prohibited from distributing their assets to members or individual shareholders, a characteristic obviously inconsistent with true charitable status. Moreover, as I noted previously, in 1985 Congress concluded that the tax exemption given to BCBS healthcare insurers, including Premera BC, had been improper because such entities were essentially commercial organizations.

There is also one other flaw in the argument that a charitable trust should be deemed to flow from Premera BC's past tax-exempt status. Just because Congress or some other governmental entity believes that there are public policy reasons to provide tax incentives to certain businesses (e.g., to encourage increased employment, which expands the tax base and keeps workers off unemployment and welfare rolls) does not and should not automatically mean that those businesses are charities or that their assets should be impressed with a charitable trust. If that were the case, Boeing, Microsoft and a large percentage of the Washington corporations engaged in the technology industry, among others, would have to be considered charities or charitable trusts under Washington law, due to their receipt of research and development tax credits, business and occupation tax breaks and other tax incentives and credits. The lack of logic in this argument is self-evident.

Q. If one were to assume that at least part of Premera's assets are subject to charitable limitations, does the Proposed Conversion satisfy the transfer requirements of the Washington Non-Profit Corporation Act?

A. Yes, I believe so. As I discussed previously, I believe that the vast majority of Premera's assets were received as payments for services rendered as part of Premera's commercial operations, and not as a result of any charitable donations. While I do not

know whether Premera may historically have acquired any of its assets subject to a specific limitation that they must be utilized for charitable purposes, I would be highly skeptical that even a majority of Premera's current assets are subject to such explicit limitations. I believe that most, if not all, of Premera's existing assets have been accumulated through the reinvestment of payments from commercial customers into Premera's business, and I doubt that any of these commercial payments could be shown to have been given to Premera with a donative intent, much less subject to a restriction that the funds be used exclusively for charitable purposes. Thus, in my view, the overwhelming majority of Premera's assets cannot be subjected to a charitable trust under Washington law.

It is possible, of course, that someone might be able to make a clear showing that some of Premera's existing assets were actually received by Premera subject to explicit limitations permitting their use only for charitable purposes. Even if this were the case, it would not render Premera, in its entirety, charitable, nor would it render all of its assets charitable. If such a showing were made, the key issue would then become whether the manner in which those restricted assets are dealt with under the Proposed Conversion satisfies the requirements of RCW 24.03.225(3). In this connection, I agree with the characterization of the Washington Attorney General, in the memorandum dated October 15, 2002, co-authored by David Walsh, Rusty Fallis, and Christine Gerstung Beusch, to the effect that the proper metric is whether there are as many assets "available" for application to charitable purposes after the Proposed Conversion as there were before. At present, it is difficult to discern any significant portion of Premera's assets that is truly "available" for charitable applications—virtually all of Premera's assets are currently

utilized in the conduct of an inherently commercial business. After the Proposed Conversion, by contrast, there will be an "unlocking" of enormous value that will become available to the two Foundations and converted to cash over time. Since the stated purposes of the Foundations do appear to be "substantially similar" to the purposes that would most likely have governed any of Premera's assets that might have been received subject to charitable restrictions, it appears that the requirements of RCW 24.03.225(3) will be satisfied. In fact, it is difficult for me to understand how anyone could believe or even argue that more assets would be available for charitable uses if the Proposed Conversion were not approved.

The Premera Board fulfilled its fiduciary duties.

Q. How did the Premera Board decide to pursue the Proposed Conversion?

A. As discussed more fully in my Report and Supplemental Report, I have reviewed the Board minutes and related materials. The Premera Board grappled for an extended period of time with the limitations and vulnerabilities arising out of its relatively limited capital base. The Premera Board concluded in late 1997 that increasing Premera's capital base was a strategic priority in order for it to remain competitive and not be forced to artificially limit the growth of its business.

Q. Did the Premera Board call upon outside experts in this process?

A. Yes. In the latter half of the 1990s, the Premera Board engaged Goldman, Sachs & Company ("Goldman Sachs") to advise it with respect to its alternatives for increasing its capital base. Goldman Sachs delivered reports to the Premera Board in late 1997 that examined a wide range of capital enhancement alternatives, including an overview of business combination activities and considerations in the healthcare industry. The

Premera Board already had a great deal of familiarity with the businesses and business practices of most of these potential combination candidates.

Q. Did the Premera Board take further action with respect to the Goldman Sachs report?

A. Yes. In mid-2001, the Premera Board asked Goldman Sachs to update its analysis of alternatives for improving Premera's capital base. Goldman Sachs' updated report, delivered in preliminary form in August 2001 and in final form in September 2001, again examined a wide range of capital enhancement alternatives, including a survey of potential business combination candidates and the business and legal pros and cons of each.

Q. Did the Premera Board adequately consider the alternatives presented by Goldman Sachs?

A. Yes. The Premera Board discussed and considered each of these potential business combinations on its own merits to assess its relative desirability. More specifically, the Board considered (1) the degree to which the potential combination would deliver (a) greater capital strength and flexibility, (b) improved performance in terms of operating efficiencies and service delivery, and (c) improved competitiveness for the Premera business; (2) whether the potential combination would allow for continuation of the competitive advantage of operating under a BCBS license; (3) the degree of difficulty of achieving regulatory and antitrust approvals of the potential combination; and, finally, (4) the degree to which Premera's business would continue to be under local control after the combination. In connection with this last point, the Premera Board considered the degree to which the loss of local control would create uncertainties as to (a) possible future departure of the combined businesses from all or part of Premera's

regional market (as a number of national competitors had done during the 1990s) or (b) the effect of the combination on Premera's various constituencies, such as employer groups, subscribers, family members, physicians and other provider constituencies.

Q. How did the Premera Board apply these criteria?

A. Applying the first two criteria (namely, competitive strength and continuation of the BCBS license) narrowed the candidates down to a very small number. Acquisition by WellPoint Health Networks Inc. or Anthem, Inc., both of which were publicly held for-profit corporations, presented the most arduous regulatory approval process. The Premera Board also believed that a possible combination with a large, out-of-state BCBS licensee would result in a loss of local control, with all executive functions leaving the region and decisions that have local impacts no longer being made with particular attention to local needs and local economic considerations. A potential combination with Proprietary Material Redacted was not given extensive consideration due to the known difficulties such a combination would present from a regulatory and antitrust standpoint, and in light of anticipated opposition from providers and other constituencies. After considering all of the alternatives and the information and analysis provided by Goldman Sachs, the Premera Board concluded that the Proposed Conversion best met the four principal criteria that the Premera Board believed to be strategically important.

Q. Please summarize your conclusions about the Premera Board's due diligence and deliberative process.

A. Decisions about Premera's strategic alternatives were made by the Premera Board, not by management. Those decisions do not appear to have been influenced by self interest, and they were certainly not made in haste or on the basis of inadequate information or deliberation. In Conclusion #26 of its Supplemental Report, C&B

acknowledges that "…any weakness in PREMERA's due diligence may not compel rejection of the…[Proposed Conversion]. However, it is a significant additional factor the Commissioner may consider in evaluating whether the…[Proposed Conversion] is in the interest of policyholders and the public." Based upon my review of the Board's deliberative process, as outlined above and further in my Report, and even assuming it was a factor to consider under the Holding Company Act, I believe that there was no weakness in the due diligence of the Premera Board. The Commissioner, in evaluating the Proposed Conversion, should disregard any allegations relating to weakness in the Premera Board's due diligence or its deliberative process.

Q. In your opinion, did the deliberative process described above meet the requisite standard of care?

A. Yes. Based upon my review of the background materials and information available to me, I believe that the Premera Board's deliberative process met the requisite standard of care, and that its decision to pursue the Proposed Conversion rather than other business combination alternatives should be entitled to the protection of the "business judgment" rule, which means that such decisions are not subject to judicial second-guessing, even if those decisions are demonstrably erroneous, so long as they can be attributed to any rational business purpose.

Q. What is the applicable standard of care?

A. The standard of care for the directors of PREMERA and Premera BC is set forth in the statutes under which those corporations are organized. In general, each of Premera's directors must discharge his or her duty in good faith, in a manner the director reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person in a like position would exercise under similar circumstances.

If the directors meet this standard, their decisions are subject to the business judgment rule, which "rule" is described above. Among other things, a board such as Premera's may pursue structures or transactions designed to create long-term value. Since the Premera Board believes in good faith that there are a number of important business reasons to remain under local control and independent from larger national competitors, it is not required to focus solely on maximizing short-term financial value by selling to an out-of-state competitor.

Q. Are the duties of directors of a for-profit corporation different than those of not-for-profit corporation directors?

A. No. Despite the suggestions in the Report by Steven B. Larsen (pp. 6-7) that for-profit and not-for-profit corporations are fundamentally different in that one has shareholders and the other has only the community, directors of for-profit and not-for-profit corporations have essentially the same standard of care under Washington law—a director of each type of corporation in Washington must discharge his or her duty in good faith, in a manner the director reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person in a like position would exercise under similar circumstances. In each case, these duties look to the "best interests of the corporation" and not to the best interests of the shareholders or any other particular group of stakeholders. Directors of a not-for-profit corporation that operates a commercial business, such as Premera and New PREMERA, generally have the same mix of objectives as directors of a for-profit corporation operating a similar business. Normally, neither for-profit nor not-for-profit corporations' directors are legally obligated to maximize value for shareholders or other stakeholders. I believe that the best-run

companies do not try to maximize short-term stock price. Instead they strive to maximize long-term growth and to ignore market pressures to operate on a quarter-by-quarter basis.

Q. Is it appropriate to apply to the Proposed Conversion, by "analogy," the rules of the hospital conversion statute that require the Department of Health to examine, among others, issues of board due diligence?

A. No. Despite the suggestions in the C&B Report, I see no indication that the Washington Legislature intended the "second guessing" that is arguably authorized by RCW Ch. 70.45 as to non-profit hospital conversions to apply in hearings by any agencies other than the Department of Health, nor do I see any other reason why the Premera Board's decision should not be accorded the same deference that a corporate decision would be accorded in any other legal proceeding. As I previously described in more detail, had the Legislature intended to provide for a review of the Premera Board's due diligence and permit such "second guessing," it had ample opportunity to do so—first, in 1997 when it chose *not* to apply RCW Ch. 70.45 to healthcare insurers (unlike the model conversion statute of the NAAG on which RCW Ch. 70.45 was based); and second, in 2001 when it adopted the Holding Company Act applicable to the Proposed Conversion and did not include such "second guessing" authority. RCW Ch. 70.45 is wholly inapposite to the Proposed Conversion of Premera as a healthcare insurer, and C&B's analysis of the Premera Board's due diligence and other matters based on RCW Ch. 70.45 should be disregarded.

The overall structure of the arrangements between New PREMERA and the Foundations is reasonable and customary.

Q. In your opinion, is the overall structure of the arrangements between New PREMERA and the Foundations—including that reflected in the Registration Rights Agreement, the Voting Trust and Divestiture Agreements, and the Transfer, Grant and Loan Agreement—reasonable and customary?

A. Yes, these kinds of arrangements are fairly commonplace. You often see them in spin-offs from larger corporations. In a transaction in which a division of an existing corporation is taken public, with the original parent company still owning a large percentage, the underwriters that are conducting the public offering seek to attract investors by imposing limitations that address the public's distrust of how the big shareholder might act. For example, the public may be distrustful of the parent corporation molding the composition of the board of directors in a way that might be designed to serve the interests of the parent company rather than the interests of the newly public company. The public also may be distrustful of the integrity of the market for the stock and may want the large shareholder to reduce its holdings over time. Under such circumstances, the public generally prefers that reductions in the percentage holdings of the parent company occur according to a visible and predictable schedule, which helps reduce fears of unexpected selling pressure and price fluctuations.

Q. Do you believe that the divestiture schedule will result in the overall degradation of the value of the Washington Foundation's New PREMERA stock?

A. No, I don't.

Q. Please explain.

A. In my view, the opposite is true. If you look at large stockholders of publicly held companies, you commonly find that they engage in a program of reducing their holdings.

One reason they do this is to give the market visibility. When a large shareholder sells its holdings over a stated time period, the market is able to adjust to the fact that there is going to be some selling activity. The public knows that a methodical process will be followed, and can stop worrying about whether shares might be sold suddenly in huge quantities, and trash the market price. The view of most investment bankers is that such visibility and predictability helps support a company's stock price and makes it much less subject to fluctuation. Large shareholders also frequently optimize their liquidity by engaging in "programmed trading," which allows for continued selling of their shares according to a predetermined schedule, even when the company's insiders are in possession of inside information and would therefore otherwise be legally prohibited from trading. These mechanisms are likely, over time, to optimize the value that the Foundations receive for their shares of New PREMERA stock.

Q. Do you agree with the Blackstone Group's Update Report (p. 8) that the Voting Trust and Divestiture Agreements should expire upon any loss by New PREMERA of its right to use BCBS trademarks?

A. No. The Blackstone Group ("Blackstone"), an OIC consultant, assumes that the only reason for imposing the Voting Trust and Divestiture Agreements on the Foundations is the BCBS divestiture requirements. I believe that the continued existence of the Voting Trust Agreements during their full stated term is also important for the success of New PREMERA's initial public offering ("IPO") and subsequent market stability, regardless of the existence of the BCBS license. Agreements like the Voting Trust and Divestiture Agreement are commonplace in similar corporate transactions, and actually may enhance the value of the stock held in trust. As I stated above, where public investors may be nervous about the "overhang" of potential selling activity on the public

market price of the stock, underwriters often seek to impose restrictions that limit the large shareholder's ability to dominate voting contrary to the interests of public shareholders, and to obligate the large shareholder to reduce its percentage holdings of the public company's stock according to a visible and predictable schedule. These restrictions, which are present in the Voting Trust and Divestiture Agreements, help reduce public investors' fears of business domination, unexpected selling pressure and price fluctuations, and generally benefit both the large shareholder and the investing public from a financial perspective.

Q. The OIC consultants have a number of criticisms of the Form A Filing that are based on the notion that all of Premera's assets are subject to a charitable trust. You disagree with the premise. How do you react to the criticisms?

A. Many of the criticisms of the Form A Filing by the OIC consultants lack any legal foundation. The precise terms under which the Washington Foundation will be able to vote and monetize its shareholdings in New PREMERA have been criticized by the OIC consultants based upon the assumption that Premera is owned by the public and that all of Premera's assets are subject to a charitable trust, so the number of dollars that ultimately make their way to the Washington Foundation arguably must be maximized to the ultimate degree. For the reasons I have discussed earlier, I believe this assumption is wrong and should be disregarded. Disregarding the assumption leads me to the following conclusions:

a. **Foundation Share Allocation** -- The debate between insurance regulators in Washington and Alaska as to the division of proceeds between the Washington Foundation and the Alaska Health Foundation seems to miss the more important point that, after the Proposed Conversion, both states will

have far more assets available for charitable applications than they will have if the Proposed Conversion is not approved.

b. **Trustee Fees** -- In its Supplemental Report (p. 21), C&B argues that all fees of the trustee under the Voting Trust and Divestiture Agreements should be paid by New PREMERA rather than by the Foundations, because Premera is imposing on the Washington Foundation "unnecessary conditions." As a voluntary donor, Premera is entitled under Washington law to impose whatever requirements it desires as to the use of the donated assets. In any case, payment of a charitable trust's own operating expenses is normally considered to be within the trust's charitable purposes.

c. **Unallocated Share Escrow** -- In its Supplemental Report (p. 77), C&B argues that the application of the Unallocated Shares Escrow to shares that the states have not agreed to allocate between them "suffers from a number of serious infirmities" and that the Unallocated Shares Escrow "undermines" the transfer of the "fair value" of Premera's assets to the Washington Foundation and Alaska Health Foundation. On the contrary, the proposed escrow of unallocated shares represents a reasonable and customary mechanism for dealing with distribution of assets pending later resolution of a dispute. To deny Premera the right to employ such a mechanism in order to achieve the timing that it (the donor) desires would in effect give the donees (the Foundations) a veto over the timing of the gift—a veto which they are not legally entitled to assert. Nor does it seem to be in the public interest to allow for further delays in the process of taking New PREMERA public, which as

noted above will be the event that "unlocks" and makes available substantial value for charitable applications in the two states.

d. **Shares Outside Voting Trusts** -- In the event that BCBS does not approve the Foundations each holding 5% of all New PREMERA stock outside their respective voting trusts, and the states are unable to agree on an allocation between them of one 5% block outside the voting trusts, the Voting Trust Agreements provide that the full 5% will be allocated to the Washington Foundation. Blackstone argues, in its Update Report (p. 8), that this default provision should be eliminated and that each Foundation should be able to hold 5% of all of the New PREMERA stock outside of the respective voting trusts. The decision regarding waiver of requirements under the BCBS license will be made by the licensor and is not within Premera's control, so I believe the default provision is a necessary and reasonable safeguard to ensure that if such approval is not granted, the Foundations still have the ability to negotiate a different allocation, just not the ability to delay the Proposed Conversion while they negotiate.

e. **Restrictions on Foundations** -- C&B's argument, in its Supplemental Report (pp. 25-27, 30, 34, 86), that the required purposes and restrictions placed upon the Foundations are unreasonable, too restrictive and not in the "public interest," is inconsistent with the fact that Premera is a voluntary donor of assets, and that under Washington law a clear expression of intent to impose charitable restrictions is necessary to create charitable trusts as to the assets being gifted to the Foundations. It is more than a little ironic that C&B,

having asserted repeatedly that Premera's assets are subject to charitable restrictions, would contradict its own position by arguing that the transfers to the Foundations need not be subjected to continuing charitable restrictions.

f. **Transfer of Assets on Dissolution** -- C&B, in its Supplemental Report (p. 50), argues that Premera must be a charitable corporation, because otherwise its transfer of assets to the Foundations in the Proposed Conversion would have to "be considered a breach of the board's and management's fiduciary duty to the owners of the company." I have concluded that the proposed asset transfers are in compliance with PREMERA's Articles of Incorporation regarding dissolution, so I see no legal basis for C&B's argument that Premera's directors would be breaching their fiduciary duty *by complying with* the requirements stated in such Articles and in RCW 24.03.225(4) and (5) as to transfers upon dissolution. Not only is C&B's argument on this point insupportable under Washington law; even if it were valid, it would provide no basis for concluding that Premera's assets must be subject to charitable restrictions. C&B does not cite, and I would venture to state that there does not exist, any judicial authority for the breathtaking logical leap that if there is a fiduciary limitation against the contribution of assets to a charity, then such assets must have been subject to charitable restrictions in the first place.

Q. Are there other criticisms of the Proposed Conversion by the OIC consultants with which you do not agree?

A. Yes, there are other criticisms of the structure of the Proposed Conversion in reports filed by the OIC consultants with which I do not agree. These are some of the matters discussed in more detail in my Supplemental Report:

a. **Change of Control** -- The trigger for a free vote by the Foundations upon a change of control is a proposed issuance or transfer of more than 50.1% of New PREMERA's voting securities or business in a merger, consolidation or other transaction. Blackstone, in its Update Report (p. 17), argues that this threshold should be lowered to a proposed issuance or transfer of 20%. This change is unnecessary and problematic for at least two reasons: First, the New PREMERA shareholders, including the Foundations, are adequately protected by New PREMERA's independent board majority; and second, protection of the Foundations *has already been afforded* by the issuance of the Class B Common Stock held by the Washington Foundation, which gives the Washington Foundation the right to veto certain transactions, including issuances of stock that "would adversely affect the financial interests" of the Washington Foundation.

b. **Foundation Nominee to Premera Board** -- The Foundations have the right jointly to nominate one member of the board of directors of New PREMERA until the earliest to occur of (i) their respective ownership of New PREMERA capital stock dropping below 5% of the issued and outstanding capital stock of New PREMERA, or (ii) five years from the date of the Voting Trust and Divestiture Agreements. Blackstone argues, in its Update Report (pp. 9, 19), that the five year period is unacceptable and should be extended. I believe such a change would be atypical and inappropriate. In my experience, it is typical in a wide variety of financing, acquisition and other transactional documents for a large shareholder's negotiated right to a guaranteed board

seat to disappear when the shareholder's ownership is reduced to the 10% range, and sometimes this occurs closer to the 20% ownership level. In my experience, it would be extremely unusual for a board seat to continue to be guaranteed all the way down to the 5% ownership level, since at that level a shareholder would not hold sufficient voting power to get its director elected even under a cumulative voting format. Under the divestiture schedule set forth in the Voting Trust and Divestiture Agreements, the highest percentage ownership that either of the Foundations will hold by the fifth anniversary of the date of the Voting Trust and Divestiture Agreements is likely to be somewhere in the very low teens, and I believe this would be a typical point at which a guaranteed board seat would be lost.

c. **Director Independence** -- Blackstone argues, in its Update Report (p. 10), that the 2% of revenue test set forth in the definition of "independence" for New PREMERA's directors needs to be adjusted even though as currently drafted it is consistent with the independence rules of the New York Stock Exchange ("NYSE"). In creating this definition, the NYSE concluded that the independence test of the greater of 2% of revenues or $1 million in revenues is the most appropriate measure for determining whether directors have a "material relationship" with a listed company. I would not substitute Blackstone's judgment for that of the NYSE in this regard, especially since doing so would narrow the pool of qualified potential directors with knowledge about healthcare issues who are eligible to serve as independent directors of New PREMERA (including, specifically, physicians).

d. **Investment and Program Committees** -- C&B, in its Supplemental Report (p. 32), suggests that the specificity of functions delegated to the Investment and Program Committees under the Foundations' Bylaws raises "several serious concerns." These provisions are unusual but very appropriate to the Foundations. The directors of the Foundations will be required to deal with a number of complex financial strategy, investment banking and securities law issues, as well as issues concerning analysis and monitoring of charitable grants. The Investment Committee and the Program Committee have very different functions—the Investment Committee is charged with managing and disposing of investments, while the Program Committee is tasked with analyzing and making recommendations with respect to charitable grants, programs and other expenditures. The proper operation of each of these committees requires a different set of skills from their respective members. Good corporate governance dictates that the individuals most qualified for a function should be designated to perform that function, and I would not change the Investment and Program Committee design for this reason. Likewise, based upon similar reasoning, I would not change the requirements as to qualifications of individuals who are to serve on those committees, despite C&B's criticism (C&B's Supplemental Report, p. 32) that the requirements are overly strict and unnecessary.

e. **Foundation Board Membership Restrictions** -- Section 3.2 of the proposed Bylaws of the Foundations sets forth the qualifications and certain restrictions applicable to the potential directors for the Foundations. Excluded from

eligibility for the Washington Foundation's board, according to C&B's Supplemental Report (p. 31), are "individuals who are a member 'of any hospital or hospital association or medical association in Washington.'" In its Supplemental Report, C&B states that this exclusion is "extremely troublesome" and "quite puzzling." To me, the only puzzling part is C&B's interpretation of this section. I believe that Section 3.2(i) clearly states that a director of the Washington Foundation may not include any director, officer or employee of (i) the BCBSA or one of its licensees, (ii) any hospital or hospital association or medical association in Washington, or (iii) any other entity "engaged in the business of providing coverage or the administration of health benefits…." This language should not be read, as C&B has done, to exclude all *members* of hospitals, hospital associations or medical associations in Washington. The only use of the word "member" in Section 3.2(i) relates to "members" of the boards of directors of such organizations, which C&B has improperly read to include all members of such organizations. This mistaken reading is of particular concern when C&B, in its Supplemental Report (p. 31), states "[t]he Commissioner may have sufficient grounds to reject the [Proposed Conversion] on this basis alone."

f. **Investment Committee Role in Foundation Share Disposition** -- C&B voices concern, in its Supplemental Report (pp. 14, 32), that the Investment Committee is delegated the power, without further approval from the full board of directors, to determine the control and disposition of the Washington Foundation's holdings of shares of New PREMERA stock. I disagree with

this concern for two reasons. First, the Investment Committee is designed to be composed of individuals highly qualified to review and coordinate the Washington Foundation's trading activities, and the delegation reflected in the Washington Foundation's Bylaws is consistent with Washington law. Second, the members of the Investment Committee will be directors who bear the full complement of fiduciary obligations that apply to all directors, and will be required to listen to input from the other directors and officers and take into account any "balancing" questions in managing the asset diversification process.

g. **Restrictions on Use of Foundation Proceeds** -- C&B questions, in its Supplemental Report (pp. 33-35, 85-86), why it is necessary to afford New PREMERA enforcement rights with respect to the restrictions on "purposes" to which the Foundations may devote the proceeds of New PREMERA stock. The business interests of PREMERA in arranging for some means to enforce the restrictions seem obvious to me. Further, the transfer of New PREMERA stock is a voluntary act, and PREMERA has sensibly designated New PREMERA as the continuing corporate entity that has the power to enforce the intended restrictions of the Transfer, Grant and Loan Agreement.

h. **Foundation Share Divestiture** -- The Unallocated Shares Agreement provides that the escrow agent shall sell shares to the extent the Foundations do not in the aggregate sell 10% of their shares in the New PREMERA IPO. C&B (Supplemental Report, p. 76) sees "no apparent reason" for this provision. It is quite appropriate, in my view, to bring stability to the market

in New PREMERA stock by imposing this IPO-participation requirement, which will help the Foundations meet the 80% divestiture benchmark one year after the IPO.

i. **Appointment of the Third Board** -- The Bylaws of the Foundations provide that the Third Board (as defined in section 3.5.2) will be appointed after New PREMERA's IPO. C&B, in its Supplemental Report (pp. 31-32), alleges that Premera does not have a "good reason to prevent" appointment before the IPO. I disagree, for several reasons: (i) directors of New PREMERA at the time of the IPO will have personal liability for the contents of the IPO prospectus and should have enough knowledge and experience with New PREMERA and the IPO process to be comfortable signing the IPO documents; (ii) the underwriters will want to finalize disclosure and not deal with last-minute changes in board composition immediately prior to the IPO; and (iii) the Attorney General also appoints the Second Board and should have no particular reason to hasten appointment of the Third Board.

j. **IPO Extensions** -- C&B, in its Supplemental Report (pp. 14-15), and Blackstone, in its Update Report (p. 7), criticize the two automatic three-month extensions of time for New PREMERA to effect its IPO if there is pending litigation related to the Proposed Conversion. Due to the preparatory work involved, the need to time the IPO to a reasonably receptive stock market, and the deleterious effect pending litigation could have on the IPO, the 15- to 18-month period reflected in the Form A Filing between regulatory

approvals and IPO is not, in my view, an unnecessarily long period of time to accomplish the New PREMERA IPO.

k. **Condition to Closing of the Initial Public Offering** -- On or around the day that the IPO registration statement is declared effective, all the steps to the Proposed Conversion will be effected, and then newly formed New PREMERA, as well as the Foundations, will simultaneously sell a portion of the newly issued shares of New PREMERA stock to the public. Contrary to C&B's concern, expressed in its Supplemental Report (p. 14), that the New PREMERA IPO must occur logically before the closing of the Proposed Conversion, the consummation of the IPO is not and cannot be a precondition to the consummation of the Proposed Conversion, because the shares of New PREMERA *cannot be sold to the public* until after (albeit, only a moment after) New PREMERA has received the Premera business assets and its initial shares have in return been issued to PREMERA and then contributed to the Foundations.

l. **One Director for Two Foundations** -- Contrary to Blackstone's argument, in its Update Report (pp. 8, 19), that the Washington Foundation should have the right to nominate its own representative to the New PREMERA board of directors, I believe that "appropriate" representation can be achieved through the nomination of one director by the Foundations, with the one director reporting to both Foundations. Under Washington corporate law, the only restrictions on such reporting relationships—whether to one or a dozen shareholders—are that (i) the director must at all times be sure not to confuse

the reporting relationship with the fact that his or her fiduciary duties run to the corporation and all of its shareholders (not just those to whom he or she reports), and (ii) the director must be sure that the confidences of the corporation are maintained, which can be accomplished through a confidentiality agreement executed by the Foundations and New PREMERA. As long as these limitations are observed, there is no legal problem with a single director reporting periodically to multiple shareholders. It is unclear to me whether Blackstone, in suggesting that the Washington Foundation should have separate "representation" on New PREMERA's board, is proposing that such a separate director would have more than a reporting function, and would in fact be bound in some fashion to do the Washington Foundation's bidding as to New PREMERA board matters. If this is what Blackstone is suggesting, then I strongly disagree with the proposal, because (a) it would be inconsistent with the director's duty to represent all shareholders (see clause (i) above), and (b) it would very likely be viewed by the investing public as detracting from good corporate governance.

m. **Foundation Asset Diversification** -- In its Supplemental Report (pp. 28-30, 84), C&B makes the claim that the release of the Washington Foundation's management from the "prudent person" duty to diversify assets held in a fiduciary capacity is "too broad." Having reviewed these releases as specified in the proposed Articles of Incorporation for the Washington Foundation, I believe that they are narrowly drawn so as to be limited in their application to the board's prudence and diversification duties relative to only the New

PREMERA shares to be held by the Washington Foundation. Such narrowly drawn provisions are consistent with what I would expect reasonably skilled corporate lawyers to draft in these particular circumstances, to ensure that the directors of the Washington Foundation are not held to a standard of care that they may not be able to meet relative to diversification of the New PREMERA shareholdings. These provisions do not, in my view, bear any potential for the Washington Foundation's directors to engage in any "imprudent" conduct other than continuing to hold a concentration of New PREMERA shares, and therefore do not raise any public interest concerns. It is worth noting that these releases only relieve the directors from fiduciary duties as "trustees" under RCW Ch. 11.100—the directors will continue to have a full complement of fiduciary obligations as not-for-profit corporation directors under RCW Ch. 24.03.

Q. Does this conclude your direct testimony?

A. Yes.

Q. Do you anticipate offering responsive testimony as well?

A. Yes, I expect to address portions of the reports offered by experts that have been retained by other parties in this matter, and to respond to pre-filed testimony of those experts insofar as they touch upon matters of Washington corporate and securities law and practice.

VERIFICATION

I, John M. Steel, declare under penalty of perjury of the laws of the State of Washington that the foregoing answers are true and correct.

Executed this ____ day of March, 2004, at _____.

/s/
JOHN M. STEEL

GRAYCARY

John M. Steel

Partner

E-mail: jsteel@graycary.com
Office: 701 Fifth Avenue, Suite 7000, Seattle, WA, 98104
Telephone: 206-839-4800
Fax: 206-839-4801

Practice Group:
Corporate & Securities

Areas of Focus:
Over 25 years of experience with structuring and negotiating a wide range of financing transactions, acquisitions and strategic alliances. Has managed hundreds of private equity financings for issuers and investors and served as lead counsel on approximately thirty public offerings. Experienced in a broad variety of commercial transactions including commercial finance, licensing and distribution arrangements.

Transactional Experience:

- Represented public companies in dozens of equity financing transactions (initial and follow-on registered offerings; PIPE and 144A transactions)
- Represented acquiring companies and targets in approximately 150 merger/acquisition transactions, including anti-takeover measures
- Represented private companies and venture investors in over 200 venture capital transactions
- Assisted clients with structuring of strategic alliances, including investment and joint business arrangements
- Served as special counsel to Boards of Directors and Special Committees concerning fiduciary duties and conflicts of interest
- Advised publicly held clients on disclosure, insider trading, audit and SEC reporting issues
- Advised on executive compensation and employee incentive matters
- Represented clients in commercial finance transactions (debt facilities, equipment financing, project finance)

Professional/ Community:

- Board Member, Washington Biotechnology and Biomedical Association (2003)
- Ranked first among Washington corporate/securities lawyers in recent peer surveys conducted by *Washington Law & Politics* (Aug./Sept. 2001-2003)
- Recognized in *Seattle Magazine* as "the best corporate finance and securities lawyer in Seattle" (Jan./Feb. 2002) and among top ten business transaction lawyers (Jan./Feb. 2003)
- Awarded 2002 *Gold Glove* for best lawyer to Northwest entrepreneurial community by the Investment Forum, based on votes by 2000 entrepreneurs, VCs and service providers
- Former Chair, Corporate Act Committee of Washington State Bar Association (1993-2002)
- Former Chair, Securities Law Committee of Washington State Bar Association (1991-1992)
- Board member, Chair of Strategic Planning Committee, Washington Special Olympics (1993-1998)
- Named to *Best Lawyers in America* (1991-present) and *Who's Who in American Law* (1996-present)

Prior Professional Experience:

- Partner, Graham & James/Riddell Williams (1996-1999)
- Partner, Riddell, Williams, Bullitt & Walkinshaw (1988-1996)
- Partner, Garvey, Schubert & Barer (1970-1988)

Education:

J.D. - University of Washington (Order of the Coif)
B.A. - Stanford University

Joined Firm: 2000

Publications and Speaking Engagements:

- Speaker, "Corporate Ethics: The Legal Backdrop," Seattle University program, "Directors Training Academy" (June 2003)
- Speaker, "Term Sheets and Deal Structures," Glasser LegalWorks seminar, "SEC 'Hot Topics' Institute Spring 2003" (June 2003)
- Speaker, "Venture Capital Financing," Continuing Legal Education Seminar hosted by The Seminar Group (June 2003)
- Speaker, "2003 Legislative Amendments to the Washington State Business Corporations Act (WBCA) RCW Title 23B" part of the Washington State Bar Association program, "Business Law Section Midyear Schedule Business Law Section Midyear Meeting" (May 2003)
- Author, "Directors' Conflicting Interest Transactions," Practice Handbook
- Author, "Venture Company Series (Choosing Between ISO's and Nonqualified Options; Negotiating Preferred Stock Liquidation Preferences; Choosing the Proper Entity for a Venture-Stage Company)"
- Author, "Freedom to Hear: A Political Justification of the First Amendment," Washington Law Review